Example (1). Assume that a donor created a trust, designating his spouse as income beneficiary for life with an unrestricted power in the spouse to appoint the corpus during her life. The donor further provided that in the event the donee spouse should die without having exercised the power, the trust should continue for the life of his son with a power in the son to appoint the corpus. Since the power in the son could become exercisable only after the death of the donee spouse, the interest is not regarded as failing to satisfy the condition set forth in paragraph (a)(5) of this section.

Example (2). Assume that the donor created a trust, designating his spouse as income beneficiary for life and as donee of a power to appoint by will the entire corpus. The donor further provided that the trustee could distribute 30 percent of the corpus to the donor's son when he reached the age of 35 years. Since the trustee has a power to appoint 30 percent of the entire interest for the benefit of a person other than the donee spouse, only 70 percent of the interest placed in trust satisfied the condition set forth in paragraph (a)(5) of this section. If, in this case, the donee spouse had a power, exercisable by her will, to appoint only one-half of the corpus as it was constituted at the time of her death, it should be noted that only 35 percent of the interest placed in the trust would satisfy the condition set forth in paragraph (a)(3) of this section.

[T.D. 6334, 23 FR 8904, Nov. 15, 1958, as amended by T.D. 6542, 26 FR 552, Jan. 20, 1961, as amended by T.D. 8522, 59 FR 9659, Mar. 1, 1994; T.D. 9102, 69 FR 21, Jan. 2, 2004]

§ 25.2523(f)–1 Election with respect to life estate transferred to donee spouse.

(a) *In general.* (1) With respect to gifts made after December 31, 1981, subject to section 2523(i), a marital deduction is allowed under section 2523(a) for transfers of *qualified terminable interest property*. Qualified terminable interest property is terminable interest property described in section 2523(b)(1) that satisfies the requirements of section 2523(f)(2) and this section. Terminable interests that are described in section 2523(b)(2) cannot qualify as qualified terminable interest property. Thus, if the donor retains a power described in section 2523(b)(2) to appoint an interest in qualified terminable interest property, no deduction is allowable under section 2523(a) for the property.

(2) All of the property for which a deduction is allowed under this paragraph (a) is treated as passing to the donee spouse (for purposes of §25.2523(a)–1), and no part of the property is treated as retained by the donor or as passing to any person other than the donee spouse (for purposes of §25.2523(b)–1(b)).

(b) *Qualified terminable interest property*—(1) *Definition.* Section 2523(f)(2) provides the definition of *qualified terminable interest property*.

(2) *Meaning of property.* For purposes of section 2523(f)(2), the term *property* generally means an *entire interest in property* (within the meaning of §25.2523(e)–1(d)) or a *specific portion of the entire interest* (within the meaning of §25.2523(e)–1(c)).

(3) *Property for which the election may be made*—(i) *In general.* The election may relate to all or any part of property that meets the requirements of section 2523(f)(2) (A) and (B), provided that any partial election must be made with respect to a fractional or percentage share of the property so that the elective portion reflects its proportionate share of the increase or decrease in the entire property for purposes of applying sections 2044 or 2519. Thus, if the interest of the donee spouse in a trust (or other property in which the spouse has a qualifying income interest) meets the requirements of this section, the election may be made under section 2523(f)(2)(C) with respect to a part of the trust (or other property) only if the election relates to a defined fraction or percentage of the entire trust (or other property) or specific portion thereof within the meaning of §25.2523(e)–1(c). The fraction or percentage may be defined by formula.

(ii) *Division of trusts.* If the interest of the donee spouse in a trust meets the requirements of this section, the trust may be divided into separate trusts to reflect a partial election that has been made, if authorized under the terms of the governing instrument or otherwise permissible under local law. A trust may be divided only if the fiduciary is required, either by applicable local law or by the express or implied provisions of the governing instrument, to divide the trust according to the fair market value of the assets of the trust at the time of the division. The division of the trusts must be done on a fractional or percentage basis to reflect the partial

election. However, the separate trusts do not have to be funded with a pro rata portion of each asset held by the undivided trust.

(4) *Manner and time of making election.* (i) An election under section 2523(f)(2)(C) (other than a deemed election with respect to a joint and survivor annuity as described in section 2523(f)(6)), is made on a gift tax return for the calendar year in which the interest is transferred. The return must be filed within the time prescribed by section 6075(b) (determined without regard to section 6019(a)(2)), including any extensions authorized under section 6075(b)(2) (relating to an automatic extension of time for filing a gift tax return where the donor is granted an extension of time to file the income tax return).

(ii) If the election is made on a return for the calendar year that includes the date of death of the donor, the return (as prescribed by section 6075(b)(3)) must be filed no later than the time (including extensions) for filing the estate tax return. The election, once made, is irrevocable.

(c) *Qualifying income interest for life*—(1) *In general.* For purposes of this section, the term *qualifying income interest for life* is defined as provided in section 2056(b)(7)(B)(ii) and § 20.2056(b)–7(d)(1).

(i) *Entitled for life to all the income.* The principles outlined in § 25.2523(e)–1(f) (relating to whether the spouse is entitled for life to all of the income from the entire interest or a specific portion of the entire interest) apply in determining whether the donee spouse is entitled for life to all the income from the property, regardless of whether the interest passing to the donee spouse is in trust. An income interest granted for a term of years, or a life estate subject to termination upon the occurrence of a specified event (e.g., divorce) is not a qualifying income interest for life.

(ii) *Income between last distribution date and date of spouse's death.* An income interest does not fail to constitute a qualifying income interest for life solely because income for the period between the last distribution date and the date of the donee spouse's death is not required to be distributed to the estate of the donee spouse. See § 20.2044–1 of this chapter relating to the inclusion of such undistributed income in the gross estate of the donee spouse.

(iii) *Pooled income funds.* An income interest in a pooled income fund described in section 642(c)(5) constitutes a qualifying income interest for life for purposes of this section.

(iv) *Distribution of principal for the benefit of the donee spouse.* An income interest does not fail to constitute a qualifying income interest for life solely because the trustee has a power to distribute principal to or for the benefit of the donee spouse. The fact that property distributed to a donee spouse may be transferred by the spouse to another person does not result in a failure to satisfy the requirement of section 2056(b)(7)(B)(ii)(II). However, if the governing instrument requires the donee spouse to transfer the distributed property to another person without full and adequate consideration in money or money's worth, the requirement of section 2056(b)(7)(B)(ii)(II) is not satisfied.

(2) *Immediate right to income.* In order to constitute a qualifying income interest for life, the donee spouse must be granted the immediate right to receive the income from the property. Thus, an income interest does not constitute a qualifying income interest for life if the donee spouse receives the right to trust income commencing at some time in the future, e.g., on the termination of a preceding life income interest of the donor spouse.

(3) *Annuities payable from trusts in the case of gifts made on or before October 24, 1992.* (i) In the case of gifts made on or before October 24, 1992, a donee spouse's lifetime annuity interest payable from a trust or other group of assets passing from the donor is treated as a qualifying income interest for life for purposes of section 2523(f)(2)(B). The deductible interest, for purposes of § 25.2523(a)–1(b), is the specific portion of the property that, assuming the applicable interest rate for valuing annuities at the time the annuity interest is transferred, would produce income equal to the minimum amount payable annually to the donee spouse. If, based on the applicable interest rate, the entire property from which the annuity

may be satisfied is insufficient to produce income equal to the minimum annual payment, the value of the deductible interest is the entire value of the property. The value of the deductible interest may not exceed the value of the property from which the annuity is payable. If the annual payment may increase, the increased amount is not taken into account in valuing the deductible interest.

(ii) An annuity interest is not treated as a qualifying income interest for life for purposes of section 2523(f)(2)(B) if any person other than the donee spouse may receive during the donee spouse's lifetime, any distribution of the property or its income from which the annuity is payable.

(iii) To determine the applicable interest rate for valuing annuities, see sections 2512 and 7520 and the regulations under those sections.

(4) *Joint and survivor annuities.* [Reserved]

(d) *Treatment of interest retained by the donor spouse*—(1) *In general.* Under section 2523(f)(5)(A), if a donor spouse retains an interest in qualified terminable interest property, any subsequent transfer by the donor spouse of the retained interest in the property is not treated as a transfer for gift tax purposes. Further, the retention of the interest until the donor spouse's death does not cause the property subject to the retained interest to be includable in the gross estate of the donor spouse.

(2) *Exception.* Under section 2523(f)(5)(B), the rule contained in paragraph (d)(1) of this section does not apply to any property after the donee spouse is treated as having transferred the property under section 2519, or after the property is includable in the gross estate of the donee spouse under section 2044.

(e) *Application of local law.* The provisions of local law are taken into account in determining whether or not the conditions of section 2523(f)(2) (A) and (B), and the conditions of paragraph (c) of this section, are satisfied. For example, silence of a trust instrument on the frequency of payment is not regarded as a failure to satisfy the requirement that the income must be payable to the donee spouse annually or more frequently unless applicable local law permits payments less frequently to the donee spouse.

(f) *Examples.* The following examples illustrate the application of this section, where D, the donor, transfers property to D's spouse, S. Unless stated otherwise, it is assumed that S is not the trustee of any trust established for S's benefit:

Example 1. Life estate in residence. D transfers by gift a personal residence valued at $250,000 on the date of the gift to S and D's children, giving S the exclusive and unrestricted right to use the property (including the right to continue to occupy the property as a personal residence or rent the property and receive the income for her lifetime). After S's death, the property is to pass to D's children. Under applicable local law, S's consent is required for any sale of the property. If D elects to treat all of the transferred property as qualified terminable interest property, the deductible interest is $250,000, the value of the property for gift tax purposes.

Example 2. Power to make property productive. D transfers assets having a fair market value of $500,000 to a trust pursuant to which S is given the right exercisable annually to require distribution of all the trust income to S. No trust property may be distributed during S's lifetime to any person other than S. The assets used to fund the trust include both income producing assets and nonproductive assets. Applicable local law permits S to require that the trustee either make the trust property productive or sell the property and reinvest the proceeds in productive property within a reasonable time after the transfer. If D elects to treat the entire trust as qualified terminable interest property, the deductible interest is $500,000. If D elects to treat only 20 percent of the trust as qualified terminable interest property, the deductible interest is $100,000; i.e., 20 percent of $500,000.

Example 3. Power of distribution over fraction of trust income. The facts are the same as in *Example 2* except that S is given the power exercisable annually to require distribution to S of only 50 percent of the trust income for life. The remaining trust income may be accumulated or distributed among D's children and S in the trustee's discretion. The maximum amount that D may elect to treat as qualified terminable interest property is $250,000; i.e., the value of the trust for gift tax purposes ($500,000) multiplied by the percentage of the trust in which S has a qualifying income interest for life (50 percent). If D elects to treat only 20 percent of the portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the deductible interest is $50,000; i.e, 20 percent of $250,000.

Example 4. Power to distribute trust corpus to other beneficiaries. D transfers $500,000 to a trust providing that all the trust income is to be paid to D's spouse, S, during S's lifetime. The trustee is given the power to use annually $5,000 from the trust for the maintenance and support of S's minor child, C. Any such distribution does not necessarily relieve S of S's obligation to support and maintain C. S does not have a qualifying income interest for life in any portion of the trust because the gift fails to satisfy the condition in sections 2523(f)(3) and 2056(b)(7)(B)(ii)(II) that no person have a power, other than a power the exercise of which takes effect only at or after S's death, to appoint any part of the property to any person other than S. The trust would also be nondeductible under section 2523(f) if S, rather than the trustee, were given the power to appoint a portion of the principal to C. However, in the latter case, if S made a qualified disclaimer (within the meaning of section 2518) of the power to appoint to C, the trust could qualify for the marital deduction pursuant to section 2523(f), assuming that the power was personal to S and S's disclaimer terminates the power. Similarly, if C made a qualified disclaimer of the right to receive distributions from the trust, the trust would qualify under section 2523(f) assuming that C's disclaimer effectively negates the trustee's power under local law.

Example 5. Spouse's interest terminable on divorce. The facts are the same as in *Example 3* except that if S and D divorce, S's interest in the trust will pass to C. S's income interest is not a qualifying income interest for life because it is terminable upon S's divorce. Therefore, no portion of the trust is deductible under section 2523(f).

Example 6. Spouse's interest in trust in the form of an annuity. Prior to October 24, 1992, D established a trust funded with income producing property valued for gift tax purposes at $800,000. The trustee is required by the trust instrument to pay $40,000 a year to S for life. Any income in excess of the annuity amount is to be accumulated in the trust and may not be distributed during S's lifetime. S's lifetime annuity interest is treated as a qualifying income interest for life. If D elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the value of the deductible interest is $400,000, because that amount would yield an income to S of $40,000 a year (assuming a 10 percent interest rate applies in valuing annuities at the time of the transfer).

Example 7. Value of spouse's annuity exceeds value of trust corpus. The facts are the same as in *Example 6*, except that the trustee is required to pay S $100,000 a year for S's life. If D elects to treat the entire portion of the trust in which S has a qualifying income interest for life as qualified terminable interest property, the value of the deductible interest is $800,000, which is the lesser of the entire value of the property ($800,000) or the amount of property that (assuming a 10 percent interest rate) would yield an income to S of $100,000 a year ($1,000,000).

Example 8. Transfer to pooled income fund. D transfers $200,000 on June 1, 1994, to a pooled income fund (described in section 642(c)(5)) designating S as the only life income beneficiary. If D elects to treat the entire $200,000 as qualified terminable interest property, the deductible interest is $200,000.

Example 9. Retention by donor spouse of income interest in property. On October 1, 1994, D transfers property to an irrevocable trust under the terms of which trust income is to be paid to D for life, then to S for life and, on S's death, the trust corpus is to be paid to D's children. Because S does not possess an immediate right to receive trust income, S's interest does not qualify as a qualifying income interest for life under section 2523(f)(2). Further, under section 2702(a)(2) and § 25.2702–2(b), D is treated for gift tax purposes as making a gift with a value equal to the entire value of the property. If D dies in 1996 survived by S, the trust corpus will be includible in D's gross estate under section 2036. However, in computing D's estate tax liability, D's adjusted taxable gifts under section 2001(b)(1)(B) are adjusted to reflect the inclusion of the gifted property in D's gross estate. In addition, if S survives D, the trust property is eligible for treatment as qualified terminable interest property under section 2056(b)(7) in D's estate.

Example 10. Retention by donor spouse of income interest in property. On October 1, 1994, D transfers property to an irrevocable trust under the terms of which trust income is to be paid to S for life, then to D for life and, on D's death, the trust corpus is to be paid to D's children. D elects under section 2523(f) to treat the property as qualified terminable interest property. D dies in 1996, survived by S. S subsequently dies in 1998. Under § 2523(f)–1(d)(1), because D elected to treat the transfer as qualified terminable interest property, no part of the trust corpus is includible in D's gross estate because of D's retained interest in the trust corpus. On S's subsequent death in 1998, the trust corpus is includible in S's gross estate under section 2044.

Example 11. Retention by donor spouse of income interest in property. The facts are the same as in *Example 10*, except that S dies in 1996 survived by D, who subsequently dies in 1998. Because D made an election under section 2523(f) with respect to the trust, on S's death the trust corpus is includible in S's gross estate under section 2044. Accordingly, under section 2044(c), S is treated as the transferor of the property for estate and gift tax purposes. Upon D's subsequent death in 1998, because the property was subject to inclusion in S's gross estate under section 2044,

the exclusion rule in §25.2523(f)–1(d)(1) does not apply under §25.2523(f)–1(d)(2). However, because S is treated as the transferor of the property, the property is not subject to inclusion in D's gross estate under section 2036 or section 2038. If the executor of S's estate made a section 2056(b)(7) election with respect to the trust, the trust is includible in D's gross estate under section 2044 upon D's later death.

[T.D. 8522, 59 FR 9660, Mar. 1, 1994]

§ 25.2523(g)–1 Special rule for charitable remainder trusts.

(a) *In general.* (1) With respect to gifts made after December 31, 1981, subject to section 2523(i), if the donor's spouse is the only noncharitable beneficiary (other than the donor) of a charitable remainder annuity trust or charitable remainder unitrust described in section 664 (qualified charitable remainder trust), section 2523(b) does not apply to the interest in the trust transferred to the donee spouse. Thus, the value of the annuity or unitrust interest passing to the spouse qualifies for a marital deduction under section 2523(g) and the value of the remainder interest qualifies for a charitable deduction under section 2522.

(2) A marital deduction for the value of the donee spouse's annuity or unitrust interest in a qualified charitable remainder trust to which section 2523(g) applies is allowable only under section 2523(g). Therefore, if an interest in property qualifies for a marital deduction under section 2523(g), no election may be made with respect to the property under section 2523(f).

(3) The donee spouse's interest need not be an interest for life to qualify for a marital deduction under section 2523(g). However, for purposes of section 664, an annuity or unitrust interest payable to the spouse for a term of years cannot be payable for a term that exceeds 20 years or the trust does not qualify under section 2523(g).

(4) A deduction is allowed under section 2523(g) even if the transfer to the donee spouse is conditioned on the donee spouse's payment of state death taxes, if any, attributable to the qualified charitable remainder trust.

(5) For purposes of this section, the term *noncharitable beneficiary* means any beneficiary of the qualified charitable remainder trust other than an organization described in section 170(c).

(b) *Charitable remainder trusts where the donee spouse and the donor are not the only noncharitable beneficiaries.* In the case of a charitable remainder trust where the donor and the donor's spouse are not the only noncharitable beneficiaries (for example, where the noncharitable interest is payable to the donor's spouse for life and then to another individual (other than the donor) for life), the qualification of the interest as qualified terminable interest property is determined solely under section 2523(f) and not under section 2523(g). Accordingly, if the transfer to the trust is made prior to October 24, 1992, the spousal annuity or unitrust interest may qualify under §25.2523(f)–(1)(c)(3) as a qualifying income interest for life.

[T.D. 8522, 59 FR 9663, Mar. 1, 1994]

§ 25.2523(h)–1 Denial of double deduction.

The value of an interest in property may not be deducted for Federal gift tax purposes more than once with respect to the same donor. For example, assume that D, a donor, transferred a life estate in a farm to D's spouse, S, with a remainder to charity and that D elects to treat the property as qualified terminable interest property. The entire value of the property is deductible under section 2523(f). No part of the value of the property qualifies for a charitable deduction under section 2522 for gift tax purposes.

[T.D. 8522, 59 FR 9663, Mar. 1, 1994]

§ 25.2523(h)–2 Effective dates.

Except as specifically provided, in §§25.2523(e)–1(c)(3), 25.2523(f)–1(c)(3), and 25.2523(g)–1(b), the provisions of §§25.2523(e)–1(c), 25.2523(f)–1, 25.2523(g)–1, and 25.2523(h)–1 are effective with respect to gifts made after March 1, 1994. With respect to gifts made on or before such date, donors may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of §§25.2523(e)–1(c), 25.2523(f)–1, 25.2523(g)–1, and 25.2523(h)–1, (as well as project LR–211–76, 1984–1 C.B., page 598, see §601.601(d)(2)(ii)(*b*) of this chapter),